

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA, <i>ex rel.</i>)	
)	
STATE CORPORATION COMMISSION)	
)	CASE NO. PUE-2003-00062
In the Matter of Developing Consensus)	
Recommendations on Stranded Costs)	

RESPONSE OF VIRGINIA ELECTRIC AND POWER COMPANY

In response to the Commission's Order Establishing Proceeding dated March 3, 2003, Virginia Electric and Power Company ("Dominion Virginia Power" or the "Company") states as follows:

PRELIMINARY

The provisions of the Virginia Electric Utility Restructuring Act ("the Act") are the result of years of legislative study. No provisions of the Act generated more discussion and debate, nor received more legislative attention, than those related to stranded costs. It is therefore very helpful to review this history as we embark upon a further undertaking with regard to stranded costs. Attached to this response is an appendix (Appendix A) with an attachment, which contains the legislative background of the stranded costs provisions of the Act.

A review of the legislative background contained in Appendix A shows why the General Assembly rejected up-front calculations and asset-valuation as a means of quantifying stranded costs. The review also reveals that the legislature intentionally decided, as reflected in the Act, on a workable and flexible method of stranded costs recovery over a reasonable period of time tailored to each utility.

RESPONSES

Response to Question 1. In generic terms, stranded costs are those generation costs incurred or commitments made by utilities under cost-based regulation that the utility may not reasonably expect to recover in a competitive market.

Because of the difficulty and controversy inherent in measuring stranded costs, the General Assembly adopted a "lost revenue" or capped rate/wires charge approach to recovery of such costs, as described in Appendix A. To the extent that a utility's unbundled generation rates exceed projected market prices, as determined by the Commission, the Act permits, for a limited period of time, the utility to impose a wires charge for customers who purchase electricity supply service from a competitive service provider ("CSP"). During that same time period, customers continuing to receive electricity supply service from the utility pay capped rates. The electric energy that would have been provided to customers who buy from a CSP ("displaced energy") is assumed sold at the projected market price. These sales, combined with the wires charges imposed on the CSP customers, prevent the utility from experiencing a loss in revenues due to a customer's decision to switch to a CSP. Issues such as valuation of generation plants and NUG contracts are thus avoided because they are not related to the lost revenue or the capped rate/wires charge approach adopted by the Act.

The Commission has implemented the stranded cost provisions of the Act as required by § 56-583. The Act recognizes that "the wires charges serve as a 'proxy' . . . of stranded costs," *Application of Northern Virginia Electric Cooperative for review of tariffs and terms and conditions of service*, Case No. PUE-2002-00086, Final Order, 2002 Va. PUC LEXIS 293, *5 n.3 (June 18, 2002), because the wires charges represent the difference between the utility's generation cost under cost-based regulation and the amount expected to be recovered for sales of

displaced energy in a competitive wholesale generation market. This methodology produces a net stranded cost value by comparing the composite unbundled generation rate to the projected market price. The composite unbundled generation rate includes fossil, hydro, and nuclear assets, as well as purchases from NUGs. Use of the composite unbundled generation rate thus yields the same result as if the Commission independently compared the cost component of each resource to the projected market price, and then netted the resultant positive and negative wires charges when computing the weighted average overall wires charge. When a customer switches, this methodology assumes that the Company can recover the remaining portion of its unbundled, capped generation rate not represented by wires charges from "displaced 'power' [that] is assumed sold . . . in the wholesale power market." *In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act*, Case No. PUE-2001-00306, Final Order (Oct. 11, 2002) ("2002 Wires Charges Final Order").¹ Thus, the wires charge revenues collected represent an annual estimate of the stranded costs applicable to switching customers that are not reasonably expected to be recovered from the wholesale power market.

On the other hand, if a customer does not switch, the Act entitles the Company to continue to recover its cost of serving that customer through its capped generation rates. Such capped rates have been fixed at levels found appropriate by the Commission to enable each incumbent utility to recover its cost of service, based on the last applicable rate case held for that company (plus fuel costs), under the terms of § 56-582. For such non-switching customers, the projected market price fixed annually by the Commission in the wires charge proceeding is

¹ The docket for this case remains open. On October 25, 2002, AEP-VA filed a Petition for Reconsideration, which was granted in part in the Order on Reconsideration, dated Nov. 1, 2002. The Order on Reconsideration does not relate to this quotation.

irrelevant. Projected market prices and wires charges only become important when a customer switches to a CSP.² Until then, the utility has an obligation to continue to serve that customer with its existing plant or market purchases, and an opportunity under the Act to recover the cost of such service.

Response to Question 2. As noted, the wires charge is an estimate developed by subtracting the projected market price of generation from a utility's unbundled generation rate. Under the Act, such projected market prices are determined by the Commission on an annual basis. For example, in Case No. PUE-2001-00306, the Commission approved projected market prices for 2002. *See In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act*, Case No. PUE-2001-00306, Final Order, 2001 Va. PUC LEXIS 304 (Nov. 19, 2001) ("2001 Wires Charges Final Order").

The 2002 approved market prices of generation, which determine the wires charges by customer classes, are only estimates. Thus, any expected recovery of stranded costs provided by wires charges are estimates. After the end of each calendar year, however, Dominion Virginia Power can use the Commission-approved methodology to determine: (1) the actual market prices experienced during that year, (2) the actual wires charges that would have been collected, and (3) the actual wires charge revenue – i.e., stranded cost – that would have been recovered from customers that purchased electricity supply service from CSPs during the year.

The difference between the annual wires charge revenues collected from switching customers (based on the projected market prices of generation) and the wires charge revenues that would have been collected if the actual market prices were known represents the annual

² "Capped rates for electric generation services, only, shall also be established for the purpose of effecting customer choice for those retail customers authorized [to switch]." Code § 56-582(A)(2). "To provide the opportunity for competition . . . , the Commission shall calculate wires charges" Code § 56-583(A).

amount of over- and under-recovery. "Just and reasonable net stranded cost" is the total of the annual over- or under-recovery amounts of stranded cost for the 2001-2007 transition period. The final result (whether the utility has benefited or suffered under this methodology) cannot be known until after the end of the rate cap period in mid-2007. In the meantime, the rates determined by the Commission (including wires charges) "are reasonable and just to the utility and the public . . ." *City of Norfolk v. The Chesapeake and Potomac Telephone Co. of Virginia*, 192 Va. 292, 304, 64 S.E.2d 772, 779 (1951).

Response to Question 3. The methodology for calculating "just and reasonable net stranded costs" requires a utility to determine whether there is over- or under-recovery of stranded costs collected through the wires charges from switching customers. As noted in the response to Question 2, the Company can compare the revenue actually collected from customers via the wires charges based on projected market prices to the revenue that would have resulted had wires charges been based on the actual market prices experienced during that year. If the revenue collected through the wires charges was greater than the revenue that would have resulted had the actual market price been correctly predicted, the wires charges were set too high, resulting in an over-recovery. If the contrary is the case, then there is under-recovery. An illustration follows:

At Beginning of Year

– Capped Generation Rate	\$0.05 per kWh
– Projected Market Price	\$0.04 per kWh
– Wires Charge Set by the Commission	\$0.01 per kWh

After End of Year – Market Price is Higher Than Projected by SCC

– Capped Generation Rate	\$0.05 per kWh
– Actual Market Price During Year	\$0.045 per kWh

- Wires Charge based on Actual Market Price \$0.005 per kWh
- Wires Charge Set by the Commission \$0.010 per kWh
- Over-recovery \$0.005 per kWh

After End of Year – Market Price is Lower Than Projected by SCC

- Capped Generation Rate \$0.05 per kWh
- Actual Market Price During Year \$0.035 per kWh
- Wires Charge based on Actual Market Price \$0.015 per kWh
- Wires Charge Set by the Commission \$0.010 per kWh
- Under-recovery \$0.005 per kWh

Response to Question 4. The Company's responses to the questions above describe the methodology and steps for recovering stranded costs through the wires charge mechanism. Additionally, as recognized in § 56-584, capped rates revenues also can provide a means for mitigation of potential stranded costs, for example, buy-outs of NUG contracts and write-off of regulatory assets. However, it must be emphasized that the primary function of a utility's capped rate revenues is the continued safe and reliable provision of service to customers who have not switched to a CSP (i.e., its cost of service).

Dominion Virginia Power has significant potential stranded cost exposure and is seeking to mitigate such costs through buy-outs of above-market power purchase contracts as funds become available, by lowering other costs, and by improving operational efficiencies where possible. At the same time, the Company continues to incur new obligations relating to environmental compliance and major maintenance projects that cannot be passed on to customers under the rate cap. Whether future wires charges and funds available from capped rates will result in adequate recovery depends upon a number of factors and, particularly, market prices. Since 1999, market prices for electricity have fluctuated significantly and will likely continue to be volatile. The Act's approach to stranded cost recovery strikes a balance between utilities and

customers. It also eliminates projections and the associated risk of incorrect data input and assumptions. Whether the methodology implemented by the Act will permit full mitigation of stranded costs depends upon a number of factors that cannot be finally determined until the recovery period ends on July 1, 2007.

Response to Question 5. The calculation and recovery of stranded costs through wires charges may produce an over-recovery or an under-recovery of stranded costs in any particular year. However, for the reasons stated above, an over-recovery or under-recovery of the Company's system or jurisdictional stranded costs through that wires charge mechanism and any additional funds applied to stranded costs mitigation measures from capped rate revenues cannot be finally determined until after July 1, 2007. Such over- or under-recovery will be highly dependent upon the accuracy of the projected market prices of generation and resultant wires charges set annually by the Commission.

Response to Question 6. "When the language of a statute is plain and unambiguous, we are bound by the plain meaning of that statutory language." *Lee County v. Town of St. Charles*, 264 Va. 344, 348, 568 S.E.2d 680, 682 (2002); *Industrial Dev. Auth. v. Board of Supervisors*, 263 Va. 349, 352, 559 S.E.2d 621, 623 (2002); *Cummings v. Fulghum*, 261 Va. 73, 77, 540 S.E.2d 494, 496 (2001); *Vaughn, Inc. v. Beck*, 262 Va. 673, 677, 554 S.E.2d 88, 90 (2001). The phrase "consistent with the provisions of the Act" is plain and unambiguous language, and therefore does not require further interpretation. Indeed, the legislative background of the Act, the Commission's implementation of the Act, and the explicit requirement in § 56-595 that the LTTF monitor the recovery of stranded costs as provided in § 56-584, guide and constrain the actions of the work group. Unless the Commission is wrong in its interpretation and implementation – and, to the Company's knowledge, no one has made such claim – the

methodology in the 2001 and 2002 Wires Charges Final Orders accomplishes what the Act requires.

Response to Question 7. The Company, in the 1996 Cases³, filed a transition cost report. This report was not a stranded cost study but a proposed methodology with an analysis presented for illustrative purposes based on a given set of assumptions. The methodology in the report showed \$3.2 billion in stranded costs on a system basis (\$2.5 billion on a Virginia jurisdictional basis).⁴ Since that filing, the Company has not performed stranded cost studies except as provided for in the Act and as implemented by the Commission. The Company, however, has conducted two high-level studies that show above market costs for the NUG contracts. These studies, which were conducted in early 2002 and again in early 2003, were intended to give an order of magnitude assessment. The studies do not contain the detailed data inputs and assumptions contained in the 1996 Cases, but continue to show – as the Commission has found in the 2001 and 2002 Wires Charges Final Orders – that the Company has considerable stranded cost exposure.

Response to Question 8. Until July 1, 2007, the Company can calculate the amounts it has expended to mitigate potential stranded costs (less any additional expenditures that negatively impact such costs) and its over-recovery or under-recovery of net just and reasonable stranded costs. During that time, the Commission's implementation of the Act allows the General Assembly and, particularly, the LTTF, to monitor the Commission's estimate of

³ *Virginia Electric and Power Company, 1995 Annual Information Filing and Commonwealth of Virginia at the relation of the State Corporation Commission, Ex Parte: Investigation of Electric Utility Industry Restructuring – Virginia Electric Power Company*, Case Nos. PUE-1996-00036 and PUE-1996-00296, 1998 S.C.C. Ann. Rept. 322 (August 7, 1998) ("1996 Cases").

⁴ The General Assembly rejected the quantification approach, such as proposed in the transition cost report, in favor of the "lost revenue" approach as described in Appendix A.

potential stranded costs on an annual basis. It also allows Dominion Virginia Power to calculate net stranded cost exposure and its over-recovery or under-recovery for each annual period.

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